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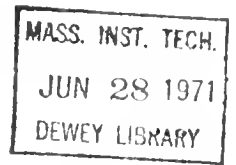
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Social Accounting for Corporate Managers

This paper identifies the need of a system of accounting for those corporate activities which have other than traditionally quantifiable financial consequences. Whether these activities are consciously undertaken or are the by-products of corporate operations, it is suggested that they should be accounted both to the public and to internal managers through the establishment of a system of social accounting, a term coined by others, but appropriate to our purposes.

The authors are aware that the ideas offered here are only a beginning inquiry into a topic of growing significance, and that widely divergent debate is needed to direct attention toward definitive forms to fulfill the perceived need. We cheerfully anticipate argument and criticism; and expect that the last word on the subject is far, far away--perhaps even light years away. Since arguments over traditional accounting principles continue to absorb the attention of interest groups, it is surely reasonable to expect that social accounting will create problems requiring full discussion by conflicting parties: and to hope that more interest will generate light on a presently unlit area.

Aroused Interest in Social Responsibility

Headlines and newspaper stories in recent years give the impression that the public is suddenly becoming aware of certain anti-social aspects of corporate operations. Student obstruction of corporate recruiting at universities, consumer strikes at retail stores, sit-ins at corporate headquarters, and demonstrations of various groups against corporate hiring practices, ecological damage, poorly designed products, and other apparent malfeasance and misfeasance have forced corporate managers and directors to sit up and take notice.

While the socially directed activities of interest groups capture the headlines, it is of interest to note that many corporate managers have treated the subject for decades. (This is not to say that very much has necessarily been done about it by many managers.) In our experience, corporate managers have seemed to adopt one of three general approaches. Some managers have recognized the growing need of some kind of attitude toward social responsibility, but have chosen to ignore it. They say, "Our function is to maximize profit, so as to facilitate growth of the business and returns to our investors. This is our primary task, and we shall pursue it. We are not law breakers, we do not consciously offend anybody, but we cannot afford the luxury of diverting our energies from our primary function." A second group of executives has recognized that somebody out there is complaining about certain corporate activities, or side-effects, but they take a strong stand against any encroachment of their prerogatives. They have chosen actively to oppose any outside activities that remotely smack of interference with management authority. A third group of executives has recognized the growing interest in corporate responsibility as a factor in the environment which affects corporate operations. This group of managers has come to realize that the long-run success of the firm may even be enhanced if the subject is factored into planning activities.

Observation of corporate operations in recent years suggests that there may be a trend toward adoption of the third alternative. In fact, there is evidence that some firms have recognized the positive aspects of social responsibility for decades, and have attempted to do something about them. For example, while Dow Chemical Company has become famous for the anti-napalm demonstrations, the fact is that the company has for nearly two generations planned its manufacturing processes so as to reduce or eliminate ecological

damage. In the case of Eastern Gas & Fuel Associates, participation through its Boston Gas Company subsidiary in housing rehabilitation in Boston's Roxbury district is an instance of a firm which has taken a positive approach to a particular social problem, and has even profited measurably from it. In a related activity, the Olivetti Company in Italy has for generations exhibited interest in the social welfare of its employees, far above and beyond the programs of the Italian government. Many other similar instances of corporate activity are available for those who seek them out. There is a growing feeling that more corporate managers should be attending to activities over and above growth and profits alone.

The Rise of New Interest Groups

But the critics of corporate activity have now been joined by other parties with a new set of interests. For example, institutions which hold large blocks of stock in public companies have traditionally shown little or no interest in the management of the firms in which they invest. Institutions, foundations, trust officers, and even large mutual fund investors have (with only a few exceptions) historically preferred to let managers run their own enterprises, while they attended purely to management of their portfolios. This is now changing.

Institutional investors are now starting to wonder whether they are abdicating a responsibility in maintaining silence toward management of the firms in which they own substantial interest. The recent Campaign GM has forced many otherwise passive stockholders to take a stand on issues of corporate management. And there are now lesser publicized campaigns of a similar nature being directed at other firms.

Investors are starting to ask themselves whether they should continue their own investment activity simply on the basis of traditional investment criteria. Bankers and other capital suppliers are also becoming interested in the ramifications of their borrowers' activities. There are direct short-term and long-term costs related to demonstrations, sit-ins, boycotts, and other interference with corporate activities, with the result that investors and lenders now see an additional risk factor that must be reckoned with in making their own decisions. Less visibly, some financial analysts are also dealing with this factor in judging the future profitability of the corporations which they research. Legislative activity on the part of governments, from federal to local, when added to afore-mentioned interests of the various groups with which firms must deal, suggests to corporate managers a need to do something about the subject.

An interesting development worth watching is the recent announcement by the Dreyfus Company that it is creating the Third Century Fund--a mutual fund which will invest chiefly in firms which have a positive and demonstrable interest in areas of social responsibility in addition to profitability and growth criteria.

Internal Activity

Thus far, we have dealt with a variety of groups which are external to the firm. But the manager also must consider internal needs. We do not refer simply to the interests of employees, or the new social awareness of many executives. Instead, we are referring to the needs of internal management to make better decisions. It is not enough for managers to recognize external environmental problems that must be dealt with. The subject not only has to be recognized, but it has to be defined in terms of each company's

needs, and if the firm does indeed wish to factor social responsibility into its activities, then it needs a system which will clearly identify the areas to be dealt with, and channel the feedback required by executives for control of planned activities.

If, in fact, there is a large and growing body of investors, financial backers, and others who are interested in more than mere financial reporting, then there is clearly a need for a system of external reporting which will satisfy those needs. And if corporate planning is now to include positive action in this area, then there is also a need for an internal reporting and control system covering areas of social significance. These suggestions parallel the present existence of financial accounting systems and management accounting and control systems.

Accounting attempts to bring together and classify those facts which measure the operations of firms, thereby providing internal management and external groups with the raw data required for specific decisions. Writers of annual reports notably try harder these days to abstract vital data for easier digestibility by readers. It is not sufficient, however, to provide financial accounting data for public reporting. Modern managers recognize the need for an internal management accounting and control system which reclassifies the raw data in ways which bear directly on internal needs. For both external and internal needs quantification has always been the key element in reporting systems. But more and more, qualitative inputs are a necessary ingredient for internal and external decision-making. Today there is a need to identify more of the qualitative control areas, and devise ways of reducing them to quantifiable form, so as to create more precise and objective methods of reporting and evaluating past activities and planning future conduct.

However, there is now no systematic method of reporting social activities either to the public or for internal purposes. And it does appear that parallel systems are needed for social accounting. Apparently, there are no obvious methods of dividing the firm's societal activities into clearly defined classifications for logical analysis. And while dollars are the easily measured language used to measure operating results with relatively little argument, numbers attached to systems of social accounting may turn out to be interpretations rather than precise measurements, due to the unstructured nature of the area of analysis.

A review of past work may give some clue to possible directions.

Macro-economic Social Accounting

Early work in national income accounting, much of which originated in England in World War II, has been referred to as social accounting. In a way, this terminology has ceased to be used, but the concepts developed in this area are nevertheless valuable in dividing the environment for analysis.

On the macro-economic level, "social (national income) accounting is concerned with the statistical classification of the activities of human beings and human institutions in ways which help us to understand the operation of the economy as a whole."* The concept was developed for policy considerations in national planning for the partially socialized economy of Britain. As developed, the field is economic-centered embracing "not only the classification of economic activity, but also the application of the information thus assembled to the investigation of the economic system."

*Edey and Peacock, National Income and Social Accounting, London: Hutchinson Univ. Library, 1954, p. 11.

Ibid.

The contribution of this primarily economic area is its attempt to divide the economic activity of a country into manageable segments for analysis. The economic activities tend to be divided into household, companies, public firms, government, foreign countries, and capital markets. The goal of this concept is the ability to analyze the effects of a policy decision upon the economy as a whole. This is similar to the need on the corporate level for analysis of effects of business decisions upon the firm's societal environment.

The Corporate Level

Although there have been two areas of need for social accounting described--internal control and public accountability--most of the work done in the area so far has been devoted to the latter. Among the more interesting efforts have been two projects: one originating at Stanford Business School and the other by the Council on Economic Priorities. The Stanford Study attempts to divide the environment into definable areas of concern and then rate organizations on the basis of assigned performance ratings. The CEP work also divides the environment, but opts for description of activities rather than ratings.

The Stanford Study

The Committee for Corporate Responsibility, a student group at Stanford Business School, has designed a rating system for assessing the performance of firms in the area of social responsibility. The group is in the process of analyzing a number of canning companies within a conceptual framework.

The basic analysis is on an industry level, and consists of a three dimensional matrix to rate the firms in the industry. The first dimension is a breakdown of plants within the industry. The second dimension is the listing of areas of concern for the industry, which they say are "generally considered

to be ways that the firm interfaces with the rest of the world." Areas chosen for the canning industry included Consumerism, Environmental Protection, Personnel Practices, and Community Action. These are further subdivided into such items as Packaging Information, Quality, Minority Employment, Agricultural Labor, Charitable Activity and others. The third dimension deals with various ways in which a company may be measured, by comparison with other firms in the industry, with other firms in the geographic area, with local legal requirements, potential for positive action, encouragement and cooperation with trade association actions, and encouragement and cooperation with government actions.

The composite ratings are based upon a numerical rating for each company at each matrix point, indicating a judgment by the rating team of poor, average or good. This rating is then multiplied by a significance factor to give a rating for each company or plant in each area of concern. The composite ratings are then used as a measure of social responsibility over a range in which Superior to Unacceptable are the terminal points of the range.

The CEP Approach

The Council on Economic Priorities, a non-profit group in Washington, D.C., has also made an effort in the social accounting field. The CEP is more issue-oriented than the Stanford group and the focus of its work is based on information promulgated through description and figures (such as numbers of minority employees, dollars spent in the community, etc.) rather than through rating and comparison.

The CEP keeps files on the activities of a number of large firms based upon assessment of areas of need for responsibility for each firm. Broadly speaking, these include military work, consumer protection, pollution, and

other socially-oriented issues. These files are then either merged for a breakdown on activities in a given social area or by the range of all activities by corporations. CEP views itself as a sort of social Dun and Bradstreet, with regular reports to subscribers.

Shortcomings

Both of these approaches are interesting, but fall far short of corporate external and internal needs. Perhaps the greatest weakness of both approaches is the manner in which the areas of focus are chosen. There is no attempt at a logical breakdown of the environment but rather a haphazard choice based upon currently perceived problems. When a new issue is in vogue, there must be a basic modification of the analysis.

The most obvious flaw in the Stanford study is the need to quantify interpretations of performance in the areas of concern. The quantification is very much a subjective choice and is subject to bias. An attempt is made to minimize this by allowing only three ratings, but the bias potential remains. A second major weakness is the choice of weighting factors for significance of the rating. These are also open to much debate.

The CEP method is primarily an organization of data by issue. As such, it provides a poor basis for comparison between organizations in an analysis of firms. While the Stanford study specifies areas of measurement, the CEP leaves such areas more open to the collector of the data for each firm's file on each issue. The CEP approach appears to emphasize negative aspects, and omits positive factors in corporate activities. And in both cases there are no pre-established performance goals.

A final criticism of the methods described is that the evaluations under these constraints are being done by groups which are external to

the organizations being rated. This may be inherent in social accounting, because the process of attaching meaningful measures and collecting meaningful information requires a non-biased individual or group. But no consideration is given to the needs of the firms being audited, to their goals or the constraints which limit the firm's activities.

And finally, neither group suggests that a firm should establish a system of internal reputing and control of social activities to guide management decision-making.

A Proposed Framework

The primary problem for both public accountability and control is the method of breaking down the environment into manageable sub-environments for analysis. The corporation now deals with a number of factors in its operations. These are traditionally labelled markets, labor, production, capital, government, etc. However, for social accounting purposes, these are inadequate, primarily because of their operating focus.

A more logical way to divide the environment for social accounting is to identify the various constituencies of the organization. While it is true that the relationships of some of these constituencies are not under control of the firm, nevertheless partial control exists in any relationship.

The constituencies which may be identified are:

- 1) Employees of the organization.
- 2) Consumers of the organization's products or services.
- 3) Suppliers of the organization's input materials and operating needs. (This includes employees).
- 4) Communities in which the organization operates.
- 5) Society in general.
- 6) Competitors.

All business decisions may be analyzed as to the way in which they affect these groups. There is some overlap in these constituencies, and a given decision may affect a member of more than one constituency. For example, a decision to operate a plant which pollutes a stream rather than closing it affects the individual working for the firm as an employee (He remains employed), as a member of the local community (The town's water supply is further polluted.), and as a member of society (The product remains available at the cost of a more polluted environment.)

Generally, these constituencies do exert some influence on the firm's operations. Suppliers theoretically exert control through their ability to force compliance with their wishes by ceasing to supply their inputs. Employees have both personal and union contracts. Local communities and society in general are represented through legal mechanisms. Consumers' choices may dictate policy. At least theoretically, these representations exist. Practically, with the passing of the free market system and the advent of technologies of mass environmental effect, these representatives have failed to exert any influence in control of the environment. This fact and the pressures brought to bear by it are a likely explanation for the need for a social accounting system.

For public accountability, the most likely success in social accounting may be through audit of social accounts of a given firm or industry by an independent organization similar to public accounting firms. The primary needs of a social audit are unbiased auditors and a standardized methodology for examining organizations. Such an audit could include the Stanford approach and should be made available to the public by the auditors.

For control purposes, a system of weighting and measuring may be employed internally and, as in corporate control systems, does not require public credibility. Care must be taken in providing an honest assessment of the situation by managers. If this is done, a determination of the positive and

negative social effects of a given decision may be made. This should prove valuable in a total decision, but the problem of quantifiability and structure is ever-present. How can one convert a slight overall negative social effect into dollars for comparison with economic growth? The biasing is left to the decision-maker.

Where can we go from here?

At the beginning of this discussion, the two main problems in establishing a system of social accounts were listed as dividing the environment into logical sub-environments and measuring and quantifying information. The first has proven to be relatively soluble. The second tends to limit the application of social accounting.

There is quite literally no good way of quantifying social information. The best approach would seem to embody use of a scale similar to Stanford's augmented by statistical justification and discussion of an industry as a whole. This too would best be possible through an externally conducted audit.

At this point in time, the significance of social accounting as a concept is that it exists at all. Newborn, its growth is now dependent upon the pressure of society on the corporations to develop and use it. This document has indicated a possible direction for the refinement of the concept into practicality. Suggestions on implementation are still far in the future.

We have described two external groups which have assumed an interest in auditing corporate social activities. We urge managers to adopt a method of reporting their own activities, and relating them to their own goals and constraints. Otherwise, the public may assume that the firm has no positive interest, and is concealing its negative results under a cloak of silence. Audit activities undertaken on behalf of the public by outsiders may result in reporting systems which do not consider management's goals.

And finally, if management does believe that it should activate interest in the social consequences of its operations, then an internal system of measuring and reporting the social impact of its activities must be created just as its control and information system now feeds accounting data to decision-makers.

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